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No. 89-1106

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

TRINOVA CORPORATION,
Petitioner,

v.

STATE OF MICHIGAN,
Respondent.

On Writ of Certiorari to the Supreme Court of Michigan

BRIEF FOR PETITIONER

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QUESTIONS PRESENTED

The Michigan Single Business Tax Act imposes a tax, nominally on the "privilege of doing business" within the state, measured by the "value added" by the taxpayer to the goods and services it buys. The Act's value added tax base consists of the taxpayer's labor costs (primarily wages paid to all of its employees), its capital costs (primarily depreciation and interest payments), and its profit. The Act determines the portion of this value deemed to have been added in Michigan by apportioning the tax base according to the three-factor formula of payroll, property, and sales that is widely used to apportion income under state income tax statutes.

The questions presented are:

1. Whether application to petitioner's value-added tax base of the Act's three-factor formula results in a tax on value actually added outside the state and produces a grossly distorted result, in violation of the Due Process and Commerce Clauses; and

2. Whether the Act discriminates against out-of-state businesses in favor of in-state businesses by employing an apportionment formula that, in the vast majority of cases, systematically and irrationally reduces the tax bases of the latter and increases the tax bases of the former, in violation of the Commerce Clause.

LIST OF PARTIES AND RULE 29.1 STATEMENT

Petitioner is the corporate successor to Libby-Owens-Ford Company, which commenced this action. Apart from the respondent, there were no other parties to the proceedings below. Petitioner's subsidiaries (except wholly owned subsidiaries) are these:

Aeroquip Gmbh
Aeroquip International, Inc.
Aeroquip Mexicana, S.A.
Aeroquip Vickers do Brasil, S.A.
Custom Trim of Michigan, Inc.
Korea Vickers Systems Co., Ltd.
Microfuel Systems, Inc.
Sterling INOAC Co.
Super Seals India, Ltd.
Test Systems & Simulation, Inc.
Toyo Joint Co., Ltd.
Vickers of India, Limited
Vickers Kawasaki Controls KK
Vickers Systems Gmbh
(Belgium, The Netherlands, and Switzerland)
Vickers Systems, Inc.
Yokohama Aeroquip KK

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On Writ of Certiorari to the Supreme Court of Michigan

BRIEF FOR PETITIONER

OPINIONS BELOW

The opinion of the Supreme Court of Michigan (Pet. App. 1a-28a) is reported at 433 Mich. 141, 445 N.W.2d 428 (1989). The order of the Supreme Court of Michigan denying rehearing (Pet. App. 29a) is reported at 433 Mich. 1203 (1989). The opinion of the Michigan Court of Appeals (Pet. App. 30a-41a) is reported at 166 Mich. App. 656, 421 N.W.2d 258 (1988). The opinion and order of the Michigan Court of Claims (Pet. App. 42a-51a) is not reported.

JURISDICTION

The judgment of the Supreme Court of Michigan was entered on August 21, 1989. Petitioner's timely petition for rehearing was denied on October 16, 1989 (Pet. App. 29a). The petition for a writ of certiorari was filed on January 16, 1990 and was granted on March 5, 1990.

The jurisdiction of this Court rests upon 28 U.S.C.A. § 1257(a) (West Supp. 1990).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Constitution, Amend. XIV, § 1 provides: "[N]or shall any State deprive any person of life, liberty, or property, without due process of law."

The Commerce Clause of the Constitution, Art. I, § 8, cl. 3, provides that Congress shall have Power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

Relevant portions of the Michigan Single Business Tax Act, Mich. Comp. Laws §§ 208.1-208.136 (1979), are set forth at Pet. App. 59a-62a.

STATEMENT OF THE CASE

Prior to 1976, the primary business taxes imposed by the State of Michigan were a corporate income tax, a franchise tax, a personal property tax on inventories, an intangible business tax, a financial institutions tax, an insurance company privilege fee and a savings and loan tax. These business taxes were all repealed and were replaced in 1976 by the Michigan Single Business Tax.

The Michigan Single Business Tax ("Act" or "SBT") is a form of what is generally referred to as a value added tax. Although value added taxes have been widely adopted in Europe and other countries, and there has been considerable discussion about their possible adoption in this country both at the federal and state levels, Michigan is the only state that has thus far done so.

Various aspects of state tax systems based on the "unitary business" principle and formulary apportionment have provoked repeated constitutional litigation in this Court. *E.g., Container Corp. v. Franchise Tax*

Board, 463 U.S. 159, 163-64 (1983). So far as we know, however, the Court has never considered a value added tax. This kind of tax is uncommon in this country. Thus it may be useful, before describing the SBT, to start with a discussion of the structure of value added taxes generally.

A. The Nature Of A Value Added Tax

In broad terms, a value added tax ("VAT") is a "levy based on the value added at each step in the production and distribution of a commodity or service, from the earliest stage up through the final retail sale," Note, *Value-Added Taxation: Its Concepts and Effects*, 39 U. Cin. L. Rev. 331, 333 (1970), citing Tax Foundation, Inc., *Federal Non-Income Taxes—An Examination of Selected Revenue Sources* 52 (Research Publication No. 1 New Series, 1965), or a tax on "the increase in the value of goods and services brought about by whatever a business does to them between the time of purchase and the time of sale." Haughey, *The Economic Logic of the Single Business Tax*, 22 Wayne L. Rev. 1017, 1018 (1976). Put yet another way, a VAT is a "tax levied on businesses on the value they add to their purchases of raw materials and goods and services." A. Tait, *Value Added Tax* 2 (1972); Cambridge Research Institute, *What You Should Know About The Value Added Tax* 3 (1973).

The tax may be most easily understood if it is assumed to have been adopted by a state to apply to a taxpayer that adds all the value to its product within the taxing state. With respect to the final product or service that is delivered to the ultimate consumer, portions of the value of that product or service are contributed by each of the enterprises in the chain of businesses through whose hands it passes in the course of production. Each enterprise purchases raw materials or goods from other enterprises in the chain, and then adds value to those inputs through the use of labor, capital, and the con-

tribution of its entrepreneurial effort. The value of its labor is measured by the costs incurred for compensation to workers. The value of its capital is measured by the costs incurred for interest, depreciation, and rent. The value of its entrepreneurial effort is measured by its profit when it sells the product or service.

For example, the steps in the production of a loaf of bread to the point of its retail sale to the ultimate consumer will involve, first, the transaction by which a farmer sells wheat to a miller. If we assume that the price paid by the miller to the farmer is $.12, the value added by the farmer's efforts is measured by that amount.[1] The miller, in turn, will convert the wheat into flour through the work of its employees and the use of its plant and equipment. If the payments for the use of such labor and capital are, say, $.14 and $.03, respectively, and the miller's profit is $.01, then the baker who purchases the flour from the miller will pay $.30.

This process will continue when the baker processes the flour into a loaf of bread for sale to a wholesale grocer, when the wholesale grocer packages the loaf of bread and sells it to a retail outlet, and when the retailer sells the packaged loaf of bread to the ultimate consumer. Each of these enterprises—the baker, the wholesale grocer, and the retailer—will also add value to the final product, measured, in varying quantities, by each enterprise's expenditures for labor, capital, and its entrepreneurial profit. *See* Smith, *Value-Added Tax: The Case For*, Harv. Bus. Rev., Nov.-Dec. 1970, at 77, 78, adopted from "Where's the Money Coming From," Forbes, Feb. 15, 1970, at 10.[2]

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[1] We also assume, for simplicity's sake, that the farmer has no costs for seeds or supplies.

[2] Taxation rarely is simple, and here complexities arise from the fact that there are different types of VATs, such as the so-called gross product, net income, and consumption types. *See* C. Sullivan, *The Tax on Value Added* Ch. 1 (1965); R. Kleine, *The Michigan Single Business Tax: A Different Approach to State Business*

Note that in this simplified example, the value added by each taxpayer in the chain can be determined either by adding the three elements that contribute to the value of the finished product—labor, capital, and profit—or by subtracting from the sales price the amount paid for raw materials. The literature describes these calculations as the "addition" method and the "subtraction" method. They are the two basic methods for calculating a taxpayer's value added.[3] "The results of either method are necessarily identical since subtracting purchased goods and services from total sales leaves labor cost, profit or loss, interest paid and depreciation charges—the internal payments to the factors of production that created the added value." Haughey, *supra* p. 3, at 1018-19.

B. Treatment Of Interstate Transactions

The foregoing discussion assumed goods produced and sold in a single jurisdiction. But when goods are

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Taxation 5, Advisory Commission on Intergovernmental Relations (March 1978), Cambridge Research Institute, *supra* p. 3, at 6. The difference in these types lies in the way in which they treat capital expenditures.

The Michigan SBT is a consumption-type tax using the additive method, as we explain below. Speaking generally, such a tax measures the contribution of capital investment to the value of a product by the amount of depreciation and amortization of the plant and equipment owned by the taxpayer, plus the interest and rent paid for the capital hired by the taxpayer. It is called a consumption-type tax because the value added by the use of owned capital equipment is taxed only as the equipment is consumed in the production process. *See* Shoup, *Theory and Background of the Value-Added Tax*, Proceedings of the Forty-Eighth Annual Conference on Taxation of the National Tax Association, 6, 9 (1955). The SBT adopts the view that for such a tax the tax base must be reduced, in the year in which a capital asset is acquired, by the cost of that asset, in order to avoid double taxation of the capital asset, first upon the producer of the asset, then upon the user. Haughey, *supra* p. 3, at 1027.

[3] Thus, in the case of the miller, the value added, $.18, is both the sum of $.14, $.03, and $.01 (using the addition method), and the difference between $.30 and $.12 (using the subtraction method).

produced partly in several jurisdictions and sold in several jurisdictions, one must decide whether to tax the value added where the goods are consumed or where they are produced. McLure, *State and Federal Relations in the Taxation of Value Added*, J. Corp. L., Fall 1980, at 127, 128. The European VATs with which most people are familiar employ the so-called "destination" principle, meaning that the VAT is imposed where the goods are consumed. The tax is imposed on all imports coming into the taxing jurisdiction, while all exports are sold free of tax.[4] Thus, the European VATs operate very much like retail sales taxes in the United States, except that some part of the tax is collected at each stage in the production chain. But, like a retail sales tax, the ultimate burden of the tax falls on the consumer, and the revenue from the tax benefits significantly the jurisdiction in which the consumer resides.

The alternative to the destination principle is the origin principle, under which the tax is imposed on the value added through the production of the goods *within* the taxing jurisdiction. Hence exports are taxed; imports are not. Oldman & Woods, *Would a Value-Added Tax System Relieve Tax Compliance Problems*, International Conference on Income Taxation, 1983 A.B.A. Sec.

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[4] The system is implemented in the European countries through a system of credits. Each taxpayer charges its purchasers a VAT calculated by multiplying the selling price of its goods by the applicable rate of tax. From the aggregate amount of tax it charges its customers, the taxpayer deducts the amount of VAT shown on the invoices for the goods it purchased from other firms. The net result is what the taxpayer owes the government. Hence, the tax is passed on by each firm in the chain of production to the next one until it is collected by the retailer from the final consumer, who ultimately bears the burden of the tax.

If the sales made by the firm are export sales—*i.e.*, destined for outside the taxing jurisdiction—no tax is imposed. The firm may still claim a credit for the VAT it paid on its purchases, meaning that no tax is imposed on export sales. Conversely, imports are taxed fully when they enter the country.

of Tax'n, 329 and 336 at n.79. *See* Laffer, *The International Impact of a Value-Added Tax*, J. Corp. L., Fall 1980, at 119, 119-120 ("[t]he origin principle of taxation . . . taxes all domestic value added irrespective of the location of the consumer or investor."); A. Tait, *supra* p. 3, at 16-17; Krauss and O'Brien, *Some International Implications of Value-Added Taxation*, Nat'l Tax J., Vol. XXIII, No. 4, 435, 436 (1970). Indeed, under the origin principle, the tax may be imposed on products that have been added to inventory even if there is no consumer at all. For example, if 80% of a manufacturer's products are sold, the labor and capital costs attributed to the unsold 20% are nevertheless included in the manufacturer's tax base.

Thus, the primary difference between a destination principle VAT and an origin principle VAT is the jurisdiction that reaps the tax benefit—the purchaser's jurisdiction in the case of the former, the producer's jurisdiction in the case of the latter.

While a destination principle value added tax is the commonly accepted approach in the context of international trade, experts have concluded that for practical reasons it would be virtually impossible to employ the destination principle at the state level in the United States.

> It is almost universally assumed that Congress, if it were to adopt a VAT, would follow standard practice and impose a destination-principle VAT, rather than origin-principle tax. That is, the tax would be rebated on American exports, but applied to imports. *The analogous approach would be quite unlikely, however, for interstate sales under state value added taxes. One can hardly imagine the construction of the fiscal frontiers between states that would be necessary for the collection of destination-based state value added taxes. Rather, it seems almost inevitable that state value added taxes would be based on the origin principle for interstate sales.*

McLure, *supra* p. 6, at 130-131 (emphasis supplied).

As we will see below, the SBT follows the additive approach. The American Bar Association Section of Taxation, which has extensively studied the possible use of VATs in the United States, has concluded that an additive VAT would almost certainly have to operate on the origin principle:

> [A]s a practical matter, an additive method VAT at the state level would have to be designed on an origin rather than destination principle; that is, tax would not be imposed on imports and tax would not be rebated on exports. The tax revenue would inure to the benefit of the state in which the productive activity occurred.

Evaluation of an Additive-Method Value-Added Tax for Use in the United States, Fifth Report of the Special Committee on Value-Added Tax, A.B.A. Sec. of Tax'n, 30 Tax Lawyer 565, 566 (1977) (footnote omitted).[5]

We turn now to a description of Michigan's SBT, and its actual effect on out-of-state taxpayers.

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[5] *See also, The Choice Between Value-Added and Sales Taxation at the Federal and State Levels in the United States*, Fourth Report of the Special Committee on the Value-Added Tax, A.B.A. Sec. of Tax'n, 29 Tax Lawyer 457, 465 (1976):

> In practice, the destination principle and the addition or subtraction method are mutually inconsistent. A vendor will collect the tax by adding it to the sales price. This is practical only so long as the tax is a simple percentage of the price otherwise charged. This is not the case under the addition or subtraction method. As appears in more detail below, those methods contemplate the avoidance of a cascading tax-on-tax effect through taxing each stage of the commercial chain only on its *net value added*. Since that will not be determinable until the end of the fiscal period, it is impractical, except by the grossest system of approximation, to contemplate that such a tax will be passed on to each purchaser in the commercial chain. The addition and subtraction methods are compatible with an origin-principle tax, but not with a destination-principle tax. (Emphasis supplied).

C. The Michigan Single Business Tax Act

The Michigan SBT is a value added tax (i) of the consumption type utilizing (ii) the addition method of calculation and (iii) the origin principle.[6] While it is drafted without complete fidelity to the concept or structure of a pure VAT—departing from pure value added theory in part because of the inevitable political compromises that accompany the adoption of most tax laws—the Michigan Supreme Court has expressly characterized the SBT as a value added tax of the consumption type that uses the additive method to determine a taxpayer's preapportioned tax base. *Mobil Oil Corp. v. Dep't of Treasury*, 422 Mich. 473, 496, 373 N.W.2d 730, 741 (1985).

For a taxpayer that is engaged in business within and without Michigan, the SBT is calculated in essentially two steps. First, a preapportionment tax base is calculated; then the Michigan tax base, the value considered to have been added in Michigan, is determined by applying the three-factor apportionment formula commonly used to apportion state income taxes. After certain other post-

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[6] A symposium in Volume 22 of No. 4 of the Wayne Law Review contains several articles discussing various aspects of the Act. Particularly helpful are articles by James W. Haughey, then an assistant director of the Michigan Department of Management and Budget, reportedly one of the Act's draftsmen, and by Louis W. Kasischke. *See* Haughey, *The Economic Logic of the Single Business Tax*, 22 Wayne L. Rev. 1017 (1976); Kasischke, *Computation of the Michigan Single Business Tax: Theory and Mechanics*, 22 Wayne L. Rev. 1069 (1976). There is also an elaborate monograph discussing the SBT: R. Kleine, *The Michigan Single Business Tax: A Different Approach to State Business Taxation*, Advisory Commission on Intergovernmental Relations (March 1978). A publication of the Taxation and Economic Policy Office, Michigan Department of Treasury, *Analysis of the Michigan Single Business Tax* (Jan. 1985), contains an excellent description of the SBT and a wealth of financial information concerning its impact. The *Analysis*, however, largely ignores the application and effect of the tax on companies located primarily in states other than Michigan. The Appendix, *infra*, contains three pages from the *Analysis*. The complete document has been lodged with the Clerk of the Court.

apportionment adjustments, the tax liability is determined by multiplying the result by a flat tax rate of 2.35%. Because the postapportionment adjustments are not at issue, we focus here on how the preapportioned tax base is calculated and, then, how that preapportioned tax base is assigned to Michigan pursuant to the three-factor apportionment formula.

1. *The pre-apportioned tax base.* As is true of most state income tax statutes, the SBT constructs a tax base by beginning with a readily verifiable amount—federal taxable income—and then making adjustments by adding and subtracting certain amounts. Mich. Comp. Laws §§ 208.9(1), 208.3(3) (1979). There is a critical difference, however, in both the purpose and substance of the adjustments made by Michigan's tax and the corporate income taxes of other states. Virtually all state income tax statutes require adjustments to federal taxable income in order to establish the income appropriate for state tax purposes. Thus, interest on state and municipal bonds, excluded from federal taxable income, is often regarded as properly part of state taxable income. Similarly, state income taxes, deductible from federal taxable income, are added back in arriving at state taxable income. To take another example, interest on U.S. Treasury securities, included in federal taxable income, is subtracted in determining state taxable income because that income is not taxable by a state. 31 U.S.C. § 3124 (Supp. V 1987).

There is a wholly different purpose for the adjustments made to federal taxable income by the Michigan SBT—as the Michigan Supreme Court has explained. *Mobil Oil Corp. v. Dep't of Treasury*, 422 Mich. at 497, n.15, 373 N.W.2d at 741. The objective is not to establish state taxable income, but to establish the value added by the taxpayer's relevant business activities. Moreover, the significant adjustments are unlike any that appear in any state income tax statute. They are provided for in Mich. Comp. Laws Ann. §§ 208.9(4)(c), 208.9(4)(f)

and 208.9(5) (West 1989).[7] The most significant addition, made by Mich. Comp. Laws Ann. § 208.9(5), is the amount of all compensation paid by the taxpayer (including the fringe benefits specified in Mich. Comp. Laws Ann. § 208.4(3) (West 1989)). This addition alone constitutes almost 77% of the total tax base of all taxpayers.[8]

In addition, depreciation and amortization of capital assets, whether acquired prior to or after the adoption of the SBT, are added back by § 208.9(4)(c). All interest deducted in arriving at federal taxable income—representing the cost of capital supplied by others rather than by the taxpayer—is added back by § 208.9(4)(f).[9]

Since the profit earned by a taxpayer is the third component in a value-added tax base and because profit, for this purpose, is not very different from state taxable income, the SBT provides for several additions and subtractions that are the same as those customarily made in state corporate income tax statutes.[10] The total federal

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[7] The *Analysis of the Michigan Single Business Tax, supra* note 6, at 7, explains, simply, "The SBT value-added tax base is computed by adding up profits plus labor costs plus interest paid plus depreciation."

[8] *Analysis of the Michigan Single Business Tax, supra* note 6, at 27, Table 4 (1985). This Table is reproduced in the Appendix hereto, at 1a.

[9] Amounts paid for the rent of real and personal property, which also represent the cost of capital furnished by others, are not added back—one of the Act's departures from pure VAT theory. R. Kleine, *supra* note 6, at 7, states "[t]his departure from the normal value added treatment of rent was adopted to prevent a windfall gain for a few companies . . . and to avoid placing a penalty on many companies that prefer to lease rather than buy property and equipment."

[10] The SBT allows all interest received by the taxpayer to be deducted. Mich. Comp. Laws Ann. § 208.9(7)(b). The SBT deduction is allowed, for taxpayers other than financial organizations, because, like dividends received which are also deductible under the SBT,

taxable income comes to about 6% and the additions and subtractions, other than for depreciation and interest, although numerous and technical, are not quantitatively significant.[11]

In general, and as applied to all Michigan SBT taxpayers, the average components of the SBT tax base are: compensation, which comprises 76.7% of tax base; depreciation, interest and other additions, which comprise 23.3% of tax base; business income (federal taxable income), which comprises 5.7% of tax base; and miscellaneous subtractions, which comprise a negative 5.7% of tax base.[12]

Except for the profit element, then, which may be difficult to allocate directly to each of the states in which it was earned, *see Container Corp.*, 463 U.S. at 165-169, something approximating 90% or more of the tax base can be allocated, with complete precision, to each of the states in which the contributions to that tax base were made by the taxpayer.

2. *The apportionment to Michigan of its part of the tax base.* To determine what part of the tax base is assignable to Michigan, the Act applies a percentage derived from a three-factor formula which weights payroll, property, and sales equally. Mich. Comp. Laws § 208.45 (1979). The formula is essentially the same as the familiar three-factor formula embodied in the Uniform Division of Income for Tax Purposes Act, 7A U.L.A.

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it represents earnings upon investments and not value added to the products that are sold.

[11] There are special provisions, some quite complex but not material to the issues in this case, respecting the tax bases of financial institutions and insurance companies. See Mich. Comp. Laws Ann. §§ 208.21 and 208.22 (West 1989).

[12] *Analysis of the Michigan Single Business Tax, supra* note 6, at 27, Table 4 (1985), reproduced at App. 1a.

336 (1957), which the Court has considered on numerous occasions in recent years.[13]

The amount apportioned to Michigan is reduced by certain dollar amounts, Mich. Comp. Laws Ann. § 208.35 (West 1989), and by the capital acquisition deduction.[14] The tax rate is then applied to the result, called the "adjusted tax-base." Mich. Comp. Laws Ann. § 208.31(1) and (2) (West 1989).

The Act contains a number of additional provisions which reduce the tax for certain taxpayers.[15] Moreover, if the amount representing 50% of the taxpayer's nationwide gross receipts apportioned to Michigan by the three-factor formula (ignoring the fact that the tax-

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[13] *See, e.g., Container Corp. v. Franchise Tax Bd.; Exxon Corp. v. Department of Revenue*, 447 U.S. 207 (1980); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980). "The three-factor formula yields a percentage representing an average of three ratios: property within the State to total property, payroll within the State to total payroll, and sales within the State to total sales." *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 270 n.3 (1978).

[14] Instead of being allowed against the unapportioned tax base as value-added theory would seem to require, the cost of the capital asset is first apportioned by a two-part payroll and property factor formula. Mich. Comp. Laws Ann. § 208.23(a) (West 1989). The Michigan Court of Claims recently struck down the deduction as unconstitutional on the ground that it impermissibly discriminates against out-of-state businesses by favoring businesses with all or most of their operations in Michigan. *Caterpillar Inc. v. Michigan*, Nos. 84-9664-CM and 87-11109-CM (opinion and order entered July 13, 1989, final judgment entered Aug. 11, 1989), *appeal pending*, Mich. Ct. App. No. 119584.

[15] A reduction is provided for companies that are unusually labor-intensive. Mich. Comp. Laws Ann. § 208.31(4) (West 1989). A similar reduction for capital intensive companies in the original Act has been phased out and repealed. The same is true of reductions for food retailers, private security guard companies and businesses engaged in rental investments. There is a small business credit. Mich. Comp. Laws Ann. § 208.36(2) (West 1989). Neither these, nor several other credits, are relevant to the issues presented here.

payer's gross receipts in Michigan may be known precisely) exceeds the adjusted tax base, the base is reduced (unless another deduction is available) to that amount. § 208.31(2).

D. Application Of The Tax To Petitioner

Petitioner, a manufacturer of automobile components—primarily window glass during the year at issue—is incorporated under the laws of the state of Ohio and has its principal office in Maumee, Ohio. Nearly all of petitioner's operations are located outside of Michigan and are labor and capital intensive. Pet. App. 53a, Stipulation of Facts, ¶ 5. In 1980, petitioner's presence in Michigan consisted merely of an office with six clerical workers to support eight sales people who solicited orders for petitioner's glass division and provided liaison with petitioner's Michigan customers. *Id.* ¶ 4.

The chart below identifies each component of petitioner's 1980 SBT tax base together with how that tax base was apportioned to Michigan using the Act's three-factor formula.[16] The left hand column lists the components of the tax base. The middle column reflects the percentage of the total tax base each component comprises. The right hand column shows the amount of tax base apportioned to Michigan under the three-factor formula.

Computation of Petitioner's 1980 Apportioned Tax Base

	Tax Base	Percentage of Tax Base	Apportioned Tax Base (8.9717%)
	$	%	$
U.S. taxable income (loss)	(42,466,114)	(19)	(3,809,932)

[16] The accuracy of each individual line item referenced in this chart is not in dispute nor is the mathematical accuracy of the computations that are contained in the chart.

	Tax Base	Percentage of Tax Base	Apportioned Tax Base (8.9717%)
Add:			
Compensation	226,356,271	102	20,308,006
Depreciation	23,262,909	11	2,087,078
Dividends, interest and royalties paid	22,908,950	10	2,055,322
Other	549,526		49,302
Subtotal	230,611,542	104	20,689,776
Subtract:			
Dividends, interest and royalties received	(9,486,223)	(4)	(851,076)
Total	221,125,319	100	19,838,700
Apportionment			
Payroll Factor	.2328%		
Property Factor	.0930%		
Sales Factor	26.5892%		
Average Factor	8.9717%		
Apportioned Tax Base	19,838,700 (221,125,319 × 8.9717%)		

Petitioner's apportioned tax base of $19,838,700 was adjusted by subtracting the capital acquisition deduction and by the reduction allowed for high labor compensation costs, yielding an adjusted tax base of $12,492,671 and a 1980 tax, at 2.35%, of $293,578 before credits.[17]

E. The Proceedings Below

In 1985, a panel of the Michigan intermediate court of appeals ruled that taxpayers conducting business both

[17] The statutory adjustment for high labor costs, found in Mich. Comp. Laws Ann. § 208.31(4) (West 1989), permits an SBT taxpayer a deduction to the extent that its compensation divided by its tax base exceeds 63%.

within and without Michigan, who in all relevant respects were similarly situated to petitioner, were entitled to relief under § 208.69 of the Act. Mich. Comp. Laws § 208.69 (1979).[18] That so-called "relief" provision permitted a taxpayer, when the apportionment provisions of the Act did not fairly represent the extent of a taxpayer's business activity in Michigan, to petition for employment of another method of apportionment to effectuate an equitable allocation and/or apportionment of the taxpayer's tax base.

The taxpayers in *Jones & Laughlin* had tax bases comprised almost entirely of compensation; their actual compensation paid in Michigan could be determined accurately; and application of the statutory formula resulted in an apportionment of compensation to Michigan that was substantially higher than compensation directly allocable to the state.

The court therefore allowed the taxpayers to apportion their tax bases in an alternative fashion under § 208.69—namely, by initially excluding compensation from the tax base; applying the three-factor formula to the remaining tax base; and adding to that amount the actual amount of compensation paid to employees performing services in Michigan. The decision is reprinted at Pet. App. 63a-72a. It was the precursor of the instant case and the more than 400 others that are currently pending in Michigan courts involving the same questions that are presented here.

Relying on *Jones & Laughlin*, petitioner filed a refund claim with the Michigan Department of Treasury. It

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[18] *Jones & Laughlin Steel Corp. v. Department of Treasury*, 145 Mich. App. 405, 377 N.W.2d 397 (1985), *leave to appeal and reconsideration denied*, 424 Mich. 895 (1986). Section 69 was subsequently amended in 1987, Mich. Comp. Laws Ann. § 208.69 (West 1989).

was denied. Petitioner then filed the instant action in the Michigan Court of Claims. The Court of Claims disagreed with the Department of Treasury and ordered a refund. Pet. App. 8a-9a. The Michigan Court of Appeals reversed, Pet. App. 9a, and the Michigan Supreme Court affirmed.[19]

The Michigan Supreme Court began its analysis by rejecting the Court of Claims' view of § 208.69, which it characterized as converting the section "into an all-purpose tax equity provision." Pet. App. 15a. It held, rather, that § 208.69 functioned as a "constitutional 'circuit breaker,'" to be applied only if the Act, excluding that section, was unconstitutional. Pet. App. 16a. Since it found the Act otherwise constitutional, § 208.69 did not come into play.

The Court upheld the tax, despite its acknowledgement that the "single component" at issue—compensation—accounted for "a substantial portion of the tax base in most businesses," and the entire portion in petitioner's case. Pet. App. 22a. It refused to consider, however, whether compensation or depreciation can be clearly identified on a geographical basis—or, more precisely,

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[19] Petitioner's complaint in the Court of Claims at ¶ 13 alleged that the tax as applied to it violated the Due Process and Equal Protection Clauses because of the misattribution of petitioner's tax base. That court did not reach any constitutional issue, ruling in petitioner's favor on the basis of its construction of § 208.69 of the Mich. Comp. Laws. In the Michigan Court of Appeals petitioner argued that the SBT as applied to it violated the Due Process and Commerce Clauses, Brief on Appeal, filed December 21, 1987, at 20-26, although that court too based its ruling solely on the SBT. In the Michigan Supreme Court, petitioner argued that unless relief was available under § 208.69, petitioner would be subjected to unconstitutional taxation of extraterritorial business activity in violation of both the Due Process and Commerce Clauses. Brief on Appeal, filed July 8, 1988, pp. 10-27.

whether the value added by those elements of added value can be thus identified, leaving the profit element to be apportioned. Instead, it simply ruled that apportionment of the aggregate value-added tax base was constitutionally acceptable, relying principally on an income tax case, *Container Corp.*, 463 U.S. 159, 164 (1988). Pet. App. 22a.

In that connection, the Court ruled that the Act taxes "business activity," which includes "the complete range of entrepreneurial activities of which compensating employees is but one part." Pet. App. 22a. Consequently, it stated, that

> [T]o conclude that a taxpayer's business activity is not fairly apportioned because a single component of that activity, when examined by geographical accounting, is not accurately reflected under the statutory apportionment scheme belies the very definition of business activity.

Pet. App. 22a.

On this basis, the Michigan Supreme Court adopted the *Container Corp.* analysis without further discussion, asserting that "the failings of separate accounting" in income tax cases would necessarily require apportionment in value added cases as well as income tax cases. Pet. App. 23a, n.24. The Court thus accepted the income tax apportionment formula and concluded that the tax assessed against petitioner, when judged against its overall "business activity" conducted in the state, was constitutional because the grossly disproportionate attribution of value added to Michigan was offset by the fact that the dollar amount of product delivered in Michigan—an economic activity that added comparatively little value to the product—was substantial.

> Trinova's actual Michigan compensation was $511,774, and its actual property as reflected in its depreciation expense was $2,152. While these figures obviously represent a very small percentage of Trinova's total business activity, they are offset by its Michigan sales figure of $103,981,354. When viewed as a whole, we believe the averaged ratios of Trinova's payroll, property, and sales "actually reflect a reasonable sense of how [its Michigan business activity was] generated," clearly satisfying the constitutional requirements of internal and external consistency.

Pet. App. 24a-25a (bracketed material in original; footnote omitted).

SUMMARY OF ARGUMENT

I

Michigan's use of the familiar three-factor formula to apportion petitioner's value added tax base is unjustified on a theoretical basis and in practical effect produces an unconstitutional result. The three-factor formula was conceived as an answer to the difficult task of allocating a multistate taxpayer's *income* among the various states in which it does business, *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 120-121 (1920), a task this Court has compared to "slicing a shadow," *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 192 (1983). The justification for apportionment vanishes, however, when the geographic locus of a tax base can be identified with precision. Michigan's SBT ignores this axiom. It wrongly assumes that the value added by the taxpayer's business activities cannot be specifically attributed to the states in which those activities are conducted. The assumption is wrong because the SBT itself identifies the taxpayer's value adding expenditures, and the value added by the two principal expenditures—compensation and depreciation—can and should be attributed precisely where they occur. Indeed, the State itself has conceded that if the SBT straightforwardly taxed compensation, state-by-state allocation, not apportionment, would be required. (See Pet. 12).

Michigan's SBT recognizes that a business adds value to its product through the work performed by its employees (measured by compensation), the "work" of its capital (measured by depreciation and interest paid), and management's entrepreneurial efforts (measured by profit). But compensation and depreciation, we are told by the Michigan Treasury Department, account for 90% or more of the total SBT tax base.[20] These elements of added value bear no relation to the "factors of profitability" that contribute to a multistate corporation's income, such as "functional integration, centralization of management, and economies of scale." *Mobil Oil Corporation v. Comm'r of Taxes*, 445 U.S. 425, 438 (1980). Those abstract factors baffle the effort "to characterize the income of the business as having a single identifiable 'source'." *Id.* By contrast, the source of the compensation and depreciation elements of added value lies precisely at the place where the value adding activities occur.

The consequence of Michigan's having chosen wrongly to use the three-factor apportionment formula is that the SBT cannot meet the Due Process and Commerce Clause mandate that apportionment be fair. *Container Corp.*, 463 U.S. at 169. The fair apportionment requirement means that the apportionment factors must "actually reflect a reasonable sense of how . . . [value] is generated," *id.*; that the formula not "project the taxing power of the state plainly beyond its borders" by taxing extraterritorial value, *Nashville, Chattanooga & St. L. Ry. v. Browning*, 310 U.S. 362, 365 (1940); and that the tax not lead to a "grossly distorted result." *Norfolk & Western R.R. v. State Tax Comm'n*, 390 U.S. 317, 326. Michigan's SBT fails on all counts.

The three-factor formula of property, payroll, and sales does not reflect a reasonable sense of how the SBT

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[20] *Analysis of the Michigan Single Business Tax, supra* note 6.

tax base is generated, principally because of the inclusion of the sales factor. In the typical case, as we have seen, at least 90% of the SBT tax base consists of compensation and depreciation (and in petitioner's case they constitute 113%). Sales have no relationship to the value that these two factors contribute to the tax base, and indeed have almost no role in petitioner's value adding activities. Hence they do not reflect a reasonable sense of how value was added in Michigan.

What the inclusion of the sales factor in the formula does do is this: it assigns a substantial portion of petitioner's tax base to Michigan even though almost all of the base is comprised of value adding activities—compensation and depreciation—that occurred and added value in Ohio. Thus the formula's use means that the SBT taxes value added outside Michigan's borders, in violation of the fundamental principle that states may not tax extraterritorial value.

The inclusion of the sales factor also yields a grossly distorted result. Petitioner's payroll factor (Michigan payroll over total payroll) was .2328%, its property factor .0930%. The two average .1629% and yield an apportioned tax base of $360,213. When the sales factor of 26.5892% is added the average jumps 55 times to 8.9717% and the apportioned tax base to $19,838,700. The distortion is caused because sales by themselves add almost no value. The added value associated with sales comes in one of two ways—through compensation paid to sales personnel, and through profit, assuming sales include a markup. But the compensation will already be in the tax base and will be apportioned through the payroll factor; and the value added by profit comprises only a minor element of total added value and does not merit equal treatment with the major items of payroll and property. The resulting distortion in petitioner's case can be measured not only by the jump in the apportioned tax base but also by the degree of misallocation of its principal components. Almost all of petitioner's preap-

portioned tax base consisted of site specific components—compensation and depreciation; and the parties have stipulated that petitioner's actual Michigan compensation and depreciation were $511,744 and $2,152. Pet. App. 54a-55a, Stipulation of Facts, ¶¶ 8-10. Yet the three-factor formula apportioned to Michigan $20,308,006 in compensation and $2,087,078 in depreciation. Thus, apportionment overstated actuality by 3,900% and 97,000%, respectively, and has produced a tax "out of all appropriate proportion to" petitioner's business in Michigan. *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 135 (1931).

In sum, Michigan has chosen, as it is free to have done, to adopt an additive type VAT operating on the origin principle. It is not free, however, to use the familiar three-factor formula to apportion the SBT tax base. That formula, devised to apportion state income taxes, is fundamentally inconsistent with the nature of a VAT and makes it impossible for the SBT to satisfy the requirements of the Due Process Clause and the Commerce Clause that a tax be fairly apportioned.

II

The SBT also discriminates against out-of-state businesses, in violation of the Commerce Clause. It does so by systematically reducing the tax base of businesses located principally within the state that sell their products elsewhere while systematically increasing the tax base of businesses located principally outside the state that sell their products in Michigan. Here again the villain is the sales factor, and the unconstitutional result stems from its application to a tax base composed almost entirely of compensation and depreciation. Use of a sales factor in the apportionment formula causes compensation and depreciation of those taxpayers whose labor force and physical plant are located within the state to be wrongly exported out of the state and, therefore, out of their SBT tax bases. At the same time, the formula wrongly

imports into Michigan compensation and depreciation of those taxpayers whose labor force and physical plant are located in states other than Michigan. By impermissibly favoring local enterprises while pressuring out-of-state companies to shift their operations to Michigan, the tax violates the central teachings of the Court's Commerce Clause doctrine. *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984); *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977); *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1963).

ARGUMENT

I. MICHIGAN'S USE OF AN INCOME APPORTIONMENT FORMULA TO ATTRIBUTE PETITIONER'S VALUE ADDED TAX BASE TO THE STATE IS UNJUSTIFIABLE IN THEORY AND IN PRACTICE VIOLATES THE FAIR APPORTIONMENT REQUIREMENT OF THE DUE PROCESS AND COMMERCE CLAUSES

A. There Is No Justification For The Use Of An Apportionment Formula To Assign A Value Added Tax Base Because The Principal Components Of The Value Added Tax Base Are Identifiable And May Be Precisely Allocated On A Geographical Basis

The use of a formula to divide a tax base among taxing jurisdictions is justified by the conceptual and practical difficulties that are sometimes encountered in directly delineating a tax base on a geographic basis. The Court has squarely recognized this fact in the context of state income taxation where these difficulties are especially acute. Indeed, the difficulty of accurately identifying a multistate enterprise's income tax base on a geographic basis established the essential predicate for the Court's sanction of apportioned net income taxes in its very first opinion addressed to the constitutionality of such taxes.

In *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920), the taxpayer complained that the formula employed to apportion its profits to the taxing state did not fairly reflect the portion of its profits actually received in that state. In rejecting this claim, the Court observed that "[t]he profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut, and ending with sale in other states," and the legislature "was faced with the impossibility of allocating specifically the profits earned by the processes within its borders." *Underwood*, 254 U.S. at 120-121. Because the legislature had "adopted a method of apportionment which . . . reached, and was meant to reach, only the profits earned within the state" and because there was "nothing . . . to show that the method of apportionment adopted by the state was inherently arbitrary, or that its application to this corporation produced an unreasonable result," *id.* at 121 (footnote omitted), the Court sustained the apportioned levy. *See also, Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271 (1924).

The Court's contemporary opinions involving questions of apportionment continue to recognize that the underlying justification for using an apportionment formula is the difficulty, if not impossibility, of pinpointing the tax base of a multistate business on a geographic basis. Thus, in *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 438 (1981), the Court found an apportioned net income tax justified because the 'factors of profitability arise from the operation of the business as a whole," and "it becomes misleading to characterize the income of the business as having a single identifiable 'source.'" Perhaps Justice Powell summed it up best when he observed that apportionment "owes its existence to the fact that with respect to a business earning income through a series of transactions beginning with manufacturing in one State and ending with a sale in another, a precise—or even wholly logical—determination of the State in which any

specific portion of the income was earned is impossible." *Moorman Mfg.*, 437 U.S. at 286 (Powell, J., dissenting).

Because the underlying justification for apportionment is the difficulty of determining the tax base of an interstate enterprise on a geographic basis, when the geographic locus of a tax base *can* be identified with precision the justification for apportionment evaporates. Thus, there is no warrant for apportioning an ad valorem tax on the real or immobile personal property of an interstate mercantile or manufacturing enterprise, like petitioner, and no taxing jurisdiction in the country attempts to do so. Because the geographic situs of a taxpayer's plant and immobile equipment, and its attendant value, can be identified with geographic precision, any attempt to determine the tax base by reference to an apportionment formula (containing factors other than the property itself) would necessarily lead to geographic misattribution of the tax base. An apportionment formula cannot be used as a means of permitting a state to appropriate into its tax base that which, under the state's chosen method of taxation, in fact and theory belongs to the taxing jurisdiction of another state.

There is likewise no justification for apportionment of the principal elements of Michigan's SBT base. As we have seen, the SBT is based on the origin principle of taxing value where it is added; but the apportionment used by Michigan is fundamentally inconsistent with the basic notion of such a value added tax. The primary components of value added, compensation and depreciation, are readily capable of precise territorial allocation both in theory and practice. The State itself has effectively conceded these points. It has acknowledged that, if Michigan forthrightly imposed a tax directly on compensation, it "would apply to a tax subject so inherently locale-specific as to require specific allocation" to the state in which the compensation was paid. *See* Pet. 12. And the State's stipulation as to the actual value of Trinova's Michigan compensation and depreciation (Pet.

App. 54a-55a) disposes of any suggestion that precise geographic identification of Trinova's SBT base is beset with practical difficulties.

The inappropriateness of employing an apportionment formula for determining a taxpayer's Michigan SBT base was clearly recognized by two independent economists:

> The standard three-factor formula used for determining what fraction of a multistate firm's value added should be taxable under the SBT is a cumbersome method of arriving at the wrong answer. Since value added consists of payments to labor and to capital, whose location in both cases is relatively unambiguous, there is no reason why value added in Michigan should not be measured directly.

R. Barlow and J. Connell, Jr., *The Michigan Single Business Tax in Michigan's Fiscal and Economic Structure* 673, 704 (U. Mich. Press, Braxer, H., ed. 1982).

The fundamental flaw, then, with the SBT's adoption of a formula to apportion the tax base is its false assumption that the value added by the taxpayer's business activities cannot be specifically attributed to the states in which it conducts those activities. The assumption is wrong because the Act itself identifies the expenditures of the taxpayer that add value to the inputs it receives, and the value that the two principal expenditures add can and should be attributed precisely where they are actually incurred. In this respect, the components of added value are conspicuously unlike the abstruse and elusive elements of profit that justify apportionment of net income.

A business adds value to its ultimate product principally through the efforts of its employees (reflected in their compensation), the dedication of its capital (reflected in depreciation and interest paid), and the entrepreneurial talents of its management (reflected, one may hope, in profit). The Act in § 208.9 explicitly recognizes these "inputs" to added value by constructing a tax base reflecting compensation plus depreciation plus adjusted "business income" (i.e., profit).

With the exception of profit, which is an appropriate subject for apportionment for the same reasons it is apportioned in income tax cases, these inputs of added value are demonstrably different from the "factors of profitability" that contribute to a multistate corporation's income—such as "functional integration, centralization of management, and economies of scale." *Mobil Oil Corp.*, 445 U.S. 425, 438 (1980). Those abstract and conceptual factors confound the effort "to characterize the income of the business as having a single identifiable 'source.'" *Id.* The source of the compensation and depreciation components of added value, by contrast, lies at the place where the value adding activities—production, transportation, marketing, etc.—occur, and that location can be determined precisely.

In mechanically applying this Court's income tax apportionment decisions to rationalize Michigan's apportionment of the SBT base, the Michigan Supreme Court wholly lost sight of the underlying justification for apportionment on which this Court's income tax decisions rest. For example, the Michigan court relied heavily on *Container Corp.*'s admonition that "arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice" (Pet. App. at 18a (quoting *Container Corp.*, 463 U.S. at 164)). While this observation goes far to justify apportionment of net income, whose precise territorial allocation may fairly be described as "elusive," it simply is not germane to the SBT base, whose precise territorial allocation is clearly identifiable both in theory and practice. By the same token, the Michigan court's invocation of *Container Corp.*'s remark that separate geographical accounting "often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the

components of a single enterprise," (Pet. App. at 22a, quoting *Container Corp.*, 463 U.S. at 164-165), has no bearing in the context of taxing value where it is added, largely through the distinctly unsubtle and plainly quantifiable components of compensation and depreciation.

The Michigan court also sought to defend its decision by suggesting that what Michigan really taxes is not value added, but instead an amorphous and indivisible concept called "business activity," which is no more geographically identifiable than the net income that most states tax under their corporate income taxes, and hence equally subject to apportionment. *See* pp. 17-19, *supra*. But this facile analysis cannot withstand constitutional scrutiny. As this Court has made clear, the touchstone of constitutional review of a state tax is "the practical effect of a challenged tax," *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. at 443, and "economic realities." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). Accordingly, "[t]here is no economic consequence that follows necessarily from the use of the particular words, 'privilege of doing business,' and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect." *Complete Auto*, 430 U.S. at 288. It is the same with the phrase "business activity": its use cannot obscure the question of forbidden effect. As shown above, the distinguishing feature of a value added tax such as Michigan's is that it is possible to identify precisely the components of the tax base, and to locate precisely the principal ones—compensation and depreciation. The Michigan Supreme Court cannot escape that conclusion by an *ipse dixit* which is simply inconsistent with the practical and intended effect of the tax.

B. The Application Of Michigan's Three-Factor Formula To Attribute Petitioner's Value Added Tax Base To The State (1) Does Not Reasonably Reflect The Value Petitioner Adds In Michigan, (2) Imposes A Tax On Value Petitioner Adds Outside Of Michigan, And (3) Produces A Grossly Distorted Result

There is no reason why formulary apportionment should be employed by a VAT to assign fairly to the taxing jurisdiction the principal portions of a taxpayer's total tax base. Having sought nonetheless to apportion such a tax base, Michigan must comply with the well settled constitutional principle that a tax be fairly apportioned. While the Court has articulated this principle in a variety of ways and in a variety of contexts, the essence of the fair apportionment requirement, which applies no less to value added than to income or property taxes,[21] is that "an apportionment formula must, under both the Due Process and Commerce Clauses, be fair." *Container Corp.*, 463 U.S. at 169. This means, among other things, that "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated," *id.*; that the formula not "project the taxing power of the state plainly beyond its borders" by taxing extraterritorial value, *Nashville, Chattanooga & St. Louis Ry. v. Browning*, 310 U.S. 362, 365; and that the tax not lead to "a grossly distorted result." *Norfolk & Western R. Co. v. State Tax Comm'n*, 390 U.S. 317, 326. The application of Michigan's three-factor apportionment formula to petitioner's SBT tax base fails each one of these tests.

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[21] "[I]f an apportionment method results in the taxation of a larger portion of the income, capital stock, property, *or other tax base* than is properly attributable to the state, under established legal doctrine, the taxpayers' rights, protected by the Due Process Clause, have been infringed." J. Hellerstein, *Recent Developments in State Tax Apportionment and the Circumscription of the Unitary Business*, 21 Nat'l Tax J. 487 (1968) (emphasis added, footnote omitted).

1. *The Three-Factor Formula Does Not Reflect A Reasonable Sense Of How The SBT Tax Base Is Generated*

The three-factor formula of property, payroll, and sales was developed in the context of state income taxation to reflect the contributions made by the states to the production of that income. *See State Taxation of Interstate Commerce: Report of the Special Subcomm. on State Taxation of Interstate Commerce of the House Comm. on the Judiciary*, H.R. Rep. No. 1480, 88th Cong., 2d Sess. 99-136 (1964). This Court recognized the essential justification for the three-factor formula for apportioning net income because the three factors reflect "the relative contribution of the activities in the various states to the production of the total unitary income . . . ." *Butler Bros. v. McColgan*, 315 U.S. 501, 509 (1942) (citation omitted). The Court subsequently remarked that "[t]he standard three-factor formula can be justified as a rough, practical approximation of the distribution of either a corporation's sources of income or the social costs which it generates." *General Motors Corp. v. District of Columbia*, 380 U.S. 553, 561 (1965). Indeed, the Court has now come to acknowledge that the three-factor formula is something of a "benchmark" against which other income tax apportionment formulas are judged. *Container Corp.*, 463 U.S. at 170.

The fact that the three factors in the standard income apportionment formula may reasonably reflect how income is generated, however, does not, except by sheer happenstance, mean that those factors will reflect how some other tax base is generated. It is therefore not surprising that the SBT's income tax apportionment formula fails reasonably to reflect how the SBT tax base is generated.

That is because there is no plausible justification for including a sales factor in the SBT apportionment formula. A taxpayer's sales are singularly inappropriate as a means for assigning to Michigan a tax base that

consists primarily of compensation and depreciable plant. Sales have no relationship to, and add nothing to, the value that these principal factors contribute to the tax base in Michigan. Indeed, in petitioner's case compensation and depreciation constitute 113% of the value added tax base.[22] Even allowing for a generous margin of error, sales do not "reflect a reasonable sense" of how petitioner's SBT tax base was generated in Michigan. As two outside observers have noted, the three-factor formula measures value added "incorrectly . . . by giving weight to sales, which do not measure the employment of a factor of production, and hence are not a component of value added." R. Barlow and J. Connell, Jr., *supra*, p. 26, at 704.

2. *The Application Of The Three-Factor Formula Imposes A Tax On Value Petitioner Adds Outside Of Michigan*

Perhaps the most fundamental aspect of the fair apportionment requirement is that a state may not "tax value earned outside its borders." *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982). As a result of the application of the three-factor formula to petitioner's tax base, the SBT fails to pass constitutional muster on this ground too.

As the Michigan Supreme Court has observed, the SBT taxes "the use of the resources of society. . . ." *Mobil Oil Corp. v. Department of Treasury*, 422 Mich. at 494, 373 N.W.2d at 740. Those resources, petitioner's labor and petitioner's plant, were used where they were consumed—in this case almost entirely in Ohio. Their use added value to goods ultimately delivered in Michigan, but the delivery itself did not. The value had been added before and in Ohio, when and where the labor

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[22] See Table, *supra*, pp. 14-15. Compensation ($226,356,271) and depreciation ($23,262,909) sum to $249,619,180 which, when divided by petitioner's total tax base of $221,125,319, yields 113%.

and plant were consumed. Under the origin principle of taxation, the tax on value added is levied at the source of production, *i.e.* at the origin. R. Kleine, *supra* note 6, at 7 and 14, n.5. Hence it is Ohio, not Michigan, that is entitled to tax the value added in Ohio.[23] Nevertheless, by thoughtlessly incorporating the three-factor formula into the SBT, Michigan has assigned to itself a substantial portion of the value added in Ohio. The sales factor, despite its irrelevance to an origin principle VAT, effectively assigns a disproportionate amount of tax base to the state in which petitioner makes its sales. Because petitioner makes substantial sales into Michigan, a substantial portion of petitioner's value added—which is comprised mostly of petitioner's Ohio compensation and plant—is assigned to Michigan. The application of the three-factor formula therefore violates the cardinal principle that states may not tax extraterritorial value.

3. *The Application Of The Three-Factor Formula To Petitioner's SBT Base Leads To A Grossly Distorted Result*

In large part because the three-factor formula fails reasonably to reflect petitioner's SBT base and because it sweeps extraterritorial values into that base, it imposes a tax "out of all appropriate proportion to" petitioner's business in Michigan, *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135

[23] We understand that Brazil is the only country where origin based VATs are actually used at the state level. There, each state imposes a VAT, on an origin basis, on the value added by firms within that state. M. Guerard, *The Brazilian State Value Added Tax*, International Monetary Fund Staff Papers, Vol. XX, No. 1, March 1973, pp. 118, 125-128. In 1950, Japan adopted an origin principle VAT that was to be applied at the prefecture level, but was never implemented. The tax base would have been allocated among prefectures according to payrolls except in the case of manufacturing activities for which it was to be allocated 50% on the basis of payroll and 50% on the basis of fixed assets. C. Sullivan, *supra* note 2, at 140.

(1931), and leads to "a grossly distorted result." *Norfolk & Western Ry.*, 390 U.S. at 326. Once again, these consequences may be traced to respondent's unthinking inclusion of a sales factor in the SBT apportionment formula.

The sales factor in the formula as applied to petitioner in fact measures deliveries in the state.[24] There is no value added by the delivery *per se*. Any value added that is associated with delivery is to be found in the wages of the deliverers (if they are petitioner's employees), which is already accounted for in the payroll factor.[25] Yet, for a business like petitioner's with large deliveries in Michigan but small amounts of actual compensation and depreciation (the major components of value added) inclusion of the sales factor produces a grotesque misapportionment. Petitioner's payroll factor (Michigan payroll over total payroll) was .2328%. Its property factor was .0930%. Those two factors, reflecting the major portions of added value, average .1629%, a percentage which, when applied to petitioner's tax base of $221,125,319, would yield an apportioned tax base of $360,213. When the sales factor of 26.5892% is added, however, the average jumps over 55 times to 8.9717%, and the apportioned tax base to $19,838,700, as the chart set forth below reveals:

[24] For purposes of apportionment, sales are considered to have occurred in Michigan if the destination, or point of delivery, is in Michigan, regardless of the free-on-board point or other conditions of sale. Mich. Comp. Laws § 208.52(a) (1979). Petitioner's shipment of goods to Michigan customers is F.O.B. Ohio. Thus, under the Uniform Commercial Code, the transfer of title takes place in Ohio. Mich. Comp. Laws § 440.2401(2)(a) (1979).

[25] If the deliveries are made by an independent transportation company, the employees' wages will be reflected in the compensation component of the value added tax base of that company.

Description of Line Item	Apportioned Tax Base (Using Statutory Three Factor Formula)	Apportioned Tax Base (Using Property and Payroll Factors Only)
1. Tax Base	$221,125,319	$221,125,319
2. Payroll Factor	.2328%	.2328%
3. Property Factor	.0930%	.0930%
4. Sales Factor	26.5892%	—
5. Average Factor	8.9717%	.1629%
6. Apportioned Tax Base (line 1 × line 5)	$ 19,838,700	$ 360,213

This distortion is attributable to the fact—which by now should be apparent—that sales, in and of themselves, have no proper independent function in the determination of a value added tax. Sales activities can add value in only two ways— through the compensation paid to employees engaged in sales efforts, and through profit to the extent that the sales include a markup. But the value added by compensation paid to salespersons will already be in the tax base and apportioned through the payroll factor and should not be duplicated by the sales factor. The remaining value added—profit—generally accounts for a minor percentage of total added value, and does not deserve equal footing with the major items of payroll and property. Indeed, in petitioner's case, since it suffered a loss, there was no value whatsoever added in the form of profit. Yet inclusion of the sales factor in the formula meant the difference between an apportioned tax base of $19,838,700 and $360,213.

Petitioner has clearly demonstrated the requisite "distortion" for constitutional relief. It is undisputed that compensation comprised 102% of petitioner's tax base, and that petitioner's compensation apportioned to Michigan was $20,308,006. Yet petitioner and respondent have stipulated that actual Michigan compensation—that is, compensation paid to those of petitioner's employees who performed services in Michigan—was only $511,774. Pet. App. 54a, Stipulation of Facts, ¶ 8 and ¶ 9. Thus, petitioner's apportioned Michigan compensation [26] overstated its actual Michigan compensation by 39 times, or 3,900% ($20,308,006 versus $511,774). Likewise, depreciation, which comprised 11% of petitioner's tax base, was apportioned to Michigan in the amount of $2,087,078.[27] Petitioner and respondent have stipulated that depreciation attributable to Michigan—depreciation associated with those of petitioner's depreciable assets that were physically located in Michigan—was only $2,152. Pet. App. 54a-55a, Stipulation of Facts, ¶ 8 and ¶ 10. Thus, petitioner's apportioned Michigan depreciation exceeded its actual Michigan depreciation by 970 times, or 97,000% ($2,087,078 versus $2,152).

The misguided assumption underlying the Act's apportionment provisions—that compensation and depreciation cannot be precisely identified on a geographic basis—has produced a constitutionally intolerable result in this case. In *Hans Rees' Sons*, the state's apportionment formula attributed 85% of the taxpayer's income to North Carolina, as compared to a separate accounting analysis which attributed at most 21.7%. It was "the more than 250% difference which led [the Court] to strike down the [North Carolina] tax. . . ." *Container Corp.*, 463 U.S. at 184. Yet, based on *stipulated* facts, the Act has produced distortions of 3,900% and 97,000%. These figures are far beyond "the substantial margin of error inherent in any method" of apportioning the tax base of a multistate company, *id.*, and condemn the tax.

The unconstitutionality of the SBT is not cured by the fact that Michigan could have imposed a tax upon petitioner as great as or greater than the tax imposed by the

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[26] $20,308,006, determined by multiplying total compensation of $226,356,271 times the 8.9717% average factor.

[27] Determined by multiplying total depreciation of $23,262,909 by 8.9717%

Act. Petitioner concedes that it is subject to taxation by Michigan and that Michigan could constitutionally have adopted a gross receipts tax measured by the value of the products delivered to Michigan customers. In *Moorman*, 437 U.S. at 280, the Court responded to a contention that Iowa's income tax was unconstitutional because the use by other states of apportionment formulas different from Iowa's resulted in multiple taxation. The Court held that the fact that multiple taxation might or did result did not constitute a burden on interstate commerce. A tax act has to be examined on its own, without regard to what other states might do or actually did. *Armco, Inc. v. Hardesty*, 467 U.S. 638, 644-645 (1984). In passing, the Court noted that a more burdensome form of multiple taxation could constitutionally have been imposed by Iowa in the form of a gross receipts tax.

But that *dictum* obviously did not mean that an unconstitutional tax can be supported by the state's power to raise the same amount of money by a different, constitutional tax. Indeed, the Court has held squarely to the contrary. In *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327 (1944), the Court struck down Arkansas' attempt to levy a sales tax on products sold elsewhere and delivered into Arkansas. The state defended the tax by contending that it could validly have imposed a use tax. This Court quickly disposed of that contention:

> It is suggested, however, that Arkansas could have levied a tax of the same amount on the use of these goods in Arkansas by the Arkansas buyers, and that such a use tax would not exceed the limits upon state power derived from the United States Constitution. Whatever might be the fate of such a tax were it before us, the not too short answer is that Arkansas has chosen not to impose such a use tax, as its Supreme Court so emphatically found. A sales tax and a use tax in many instances may bring about the same result. But they are different in conception, are assessments upon different transactions, and in

> the interlacings of the two legislative authorities within our federation may have to justify themselves on different constitutional grounds.

McLeod, 322 U.S. at 330. Michigan chose not to adopt—as most states have chosen not to adopt—a gross receipts tax. The fact that it might have taxed petitioner on its sales in Michigan but didn't is not relevant to the constitutional issues presented here.

Nor is it relevant that for some taxpayers (but not for petitioner) the tax base is reduced to 50% of the portion of their gross receipts that the Act arbitrarily attributes to Michigan. *See* pp. 13-14, *supra*. That does not convert the SBT into a gross receipts tax. For the large majority of taxpayers this limit is inapplicable.[28] They are taxed on the value they add to their products and services without reference to their gross receipts. As noted above, the SBT incorporates a number of departures from a "pure" VAT that serve to reduce the amount that such a tax would have imposed. *See* note 15, *supra*. The fact that one of these departures employs gross receipts as the mechanism does not make the SBT something other than a VAT and it cannot serve to convert an unconstitutional tax into one that is constitutional.

In sum, Michigan's use of a three-factor formula, designed for state income taxes, to apportion petitioner's SBT tax base has transgressed the requirements of the Due Process and Commerce Clause that a tax be fairly apportioned. That is because the formula is fundamentally inconsistent with the underlying nature of the value added tax it has chosen to adopt. Whether the constitutional infirmity be characterized as a mismatching of the tax base and the apportionment factors, the taxation of extraterritorial value, or the creation of a grossly distorted result, the conclusion is the same.

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[28] *Analysis of the Michigan Single Business Tax*, *supra* note 6, at 34, Table 8, reproduced at App. 3a.

II. THE SBT DISCRIMINATES AGAINST OUT-OF-STATE BUSINESSES, IN VIOLATION OF THE COMMERCE CLAUSE

"[T]he Commerce Clause prohibits a State from imposing a heavier tax burden on out-of-state businesses that compete in an interstate market than it imposes on its own residents who also engage in commerce among States." *American Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266, 282 (1987) (footnote omitted); *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 335 (1977). The Act's compliance with this prohibition must be analyzed in light of its overall operation and purposes, for, "[i]n its guarantee of a free trade area among States . . . the Commerce Clause has a deeper meaning that may be implicated even though state provisions . . . do not allocate tax burdens between insiders and outsiders in a manner that is facially discriminatory." *American Trucking*, 483 U.S. at 281 (footnote omitted).

Before Michigan adopted the Act it had a corporate income tax which, of course, did not tax compensation but instead treated it as a deduction in arriving at the income tax base. In replacing the corporate income tax with the Act, the legislature "intended to reduce the heavy burden of taxation on capital in Michigan."[29] The decreased burden on capital intensive industries was expected to encourage more capital investment in Michigan and stimulate the state's economic growth—i.e., "to promote the development and investment of business within Michigan." Executive Message of Michigan Governor James J. Blanchard to the Michigan Supreme Court, Pet. App. 73a (inner quotation and footnote omitted). But it also results in an "increase [in taxes] for firms in

[29] Haughey, *supra* p. 3, at 1021-1022. The intended and practical effect of the Act is discussed in detail in Haughey, *supra* p. 3, at 1021-1024. *See also*, R. Kleine, *supra* note 6, at 39-43.

labor intensive industries."[30] More important, it does so in a manner that systematically reduces the tax bases of businesses located principally within the state that sell their products elsewhere while systematically increasing the tax bases of businesses located principally outside the state that sell their products in Michigan.

The Act's systematic discrimination in favor of local and at the expense of out-of-state businesses is the inexorable consequence of the application of the familiar three-factor apportionment formula, with a sales factor, to a tax base comprised almost entirely of compensation and depreciation and interest. The point can be made with the following example. Assume two businesses, a "Michigan business" and an "Ohio business," each a mirror image of the other, with a total SBT tax base of $1,500,000, comprised, as Michigan's statistics tell us, of 77% compensation, approximately 6% profit, and, after giving effect to miscellaneous other additions and subtractions, 17% for such items as depreciation and interest. *See* p. 12, *supra*. Assume further that both businesses have property, payroll and sales in only two states, Michigan and Ohio. If the Michigan business has 98% of its property and payroll in Michigan, and 60% of its sales in Michigan, application of the three-part formula will apportion 14.67% of its compensation to Ohio.[31] If the Ohio business has 2% of its payroll and property in Michigan and 40% of its sales in Michigan, the three-part formula will attribute 14.67% of its compensation to Michigan.[32]

Thus the Ohio business, with virtually none (approximately $23,100) of its compensation in Michigan, will be

[30] *Haughey, supra* p. 3, at 1022.

[31] The arithmetic is: 98% payroll in Michigan plus 98% property in Michigan plus 60% sales in Michigan = 256%, which divided by 3 = 85.33% attributed to Michigan, and the remaining 14.67% attributed out of state.

[32] Thus: 2% payroll plus 2% property plus 40% sales = 44%, which divided by 3 = 14.67% attributed to Michigan.

taxed on $169,439 of the value added by the labor of its employees. The Michigan business, with virtually all of its compensation (approximately $1,131,900) in Michigan, will have $169,439 of the value added by its labor attributed to Ohio and *not* taxed in Michigan.[33] Thus for the Ohio business the formula attributes $146,339 *more* compensation to Michigan than it actually pays to its Michigan based employees; while, for the Michigan business, the formula attributes $146,339 *less* compensation to its Michigan employees than it actually pays those employees.[34] The foregoing example is illustrated by the following chart:

Description of Line Item	Michigan Business		Ohio Business	
Component of Tax Base	Dollar Amount	%	Dollar Amount	%
1. Compensation	$1,155,000	77%	$1,155,000	77%
2. Depreciation/ Interest	255,000	17%	255,000	17%
3. Profit	90,000	6%	90,000	6%
4. Total Tax Base (sum of lines 1, 2, 3)	$1,500,000	100%	$1,500,000	100%
	(Michigan)	(Ohio)	(Michigan)	(Ohio)
5. Payroll factor	98%	2%	2%	98%
6. Property factor	98%	2%	2%	98%
7. Sales factor	60%	40%	40%	60%
8. Average factor	85.33%	(256% + 3)	14.67%	(44% + 3)

[33] Calculated as follows: the compensation component (77%) of the $1,500,000 tax base is $1,155,000 of which 14.67% is $169,439. For the Ohio company, however, with only 2% of its payroll in Michigan, actual Michigan compensation would be approximately $23,100 (2% of $1,155,000). For the Michigan company, with 98% of its payroll in Michigan, actual Michigan compensation would be approximately $1,131,900 (98% of $1,155,000).

[34] For the Ohio business, the difference between actual compensation of $23,100 and attributed compensation of $169,349 is $146,339. For the Michigan business the figures are $1,131,900 of actual compensation and $985,561 of attributed compensation ($1,155,000 less $169,439), also yielding a difference of $146,339.

9. Actual Michigan Compensation (line 1 × line 5)	$1,131,900		$ 23,100
10. Apportioned Michigan Compensation (line 1 × line 8)	985,561		169,439
11. Over (under) Apportionment to Michigan (difference between lines 9 and 10)	(146,339)		146,339

If we extended the example by calculating the formula's effect on the depreciation component of the tax base, we would find similar results. For both taxpayers the three-part formula not only attributes amounts to the wrong place, but also does so in a way that reduces the tax base for Michigan-based companies while increasing it for out-of-state companies.

That a discriminatory result arises from application of the SBT's apportionment formula is hardly surprising. Robert Kleine, a principal draftsman of the SBT, has stated that "[a] major advantage of the VAT is that the potential exists for 'exporting' the tax to taxpayers outside the state. (A tax is exported to the extent that it is shifted forward or backward to residents outside the taxing jurisdiction.)" R. Kleine, *supra* note 6, at 23.

This result brings the Act squarely within the reach of this Court's decisions striking down other discriminatory state taxes. *American Trucking* held that Pennsylvania's flat taxes "discriminate against out-of-state vehicles by subjecting them to a much higher charge per mile traveled in the State" than the comparable charge on local vehicles. *American Trucking*, 483 U.S. at 290. The Court ruled that, since the taxes "impose a cost per mile on appellants' trucks that is approximately five times as heavy as the cost per mile borne by local trucks, the taxes are plainly discriminatory." *Id.* at 286 (footnote omitted). Michigan's SBT likewise discriminates against out-of-state businesses by imposing on them a far greater tax

burden per dollar of actual value added in Michigan than the tax imposes on taxpayers with their labor force and physical plant located principally within the state.

Similarly, in *Maryland v. Louisiana*, 451 U.S. 725, 757 (1981), the Court invalidated a Louisiana tax scheme on the ground that its "obvious economic effect . . . is to encourage natural gas owners involved in the production of [Outer Continental Shelf] gas to invest in mineral exploration and development within Louisiana rather than to invest in further OCS development or in production in other States." And in *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388 (1984), this Court struck down a New York statute which provided a greater tax credit for export activity originating in, rather than out of, the state. The Court ruled that "[w]hether the . . . [New York credit] diverts new business into the State or merely prevents current business from being diverted elsewhere, it is still a discriminatory tax . . . ." *Westinghouse*, 466 U.S. at 406.

While the above referenced cases involved tax credits and tax exemptions which favored local business, the discriminatory effect of the Act's three-factor apportionment formula as applied against the tax bases of in-state and out-state taxpayers is not constitutionally different. Like credits or exemptions, the SBT apportionment formula must be condemned for " 'providing a direct commercial advantage to local business'." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977) (citation omitted). Additional support for this proposition may be found in *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1963) where this Court observed:

> In each case it is our duty to determine whether the statute under attack, whatever its name may be, will *in its practical operation* work discrimination against interstate commerce.

373 U.S. at 69 (emphasis supplied), *quoting*, *Best & Co. v. Maxwell*, 311 U.S. 454, 455-456 (1940). *See also*, *Westinghouse*, 446 U.S. at 404-405.

In short, the Michigan legislature has adopted an apportionment formula that inexorably skews the tax base in favor of Michigan businesses engaged in interstate commerce over out-of-state businesses engaged in interstate commerce. The three-factor formula systematically underattributes to Michigan the site-specific tax base components—compensation and depreciation—of in-state businesses while systematically overattributing to Michigan those same site-specific tax base components of out-of-state businesses. It accomplishes this result by assigning those tax base components in part on the basis of the taxpayer's sales which effectively export the local taxpayer's SBT base while importing the out-of-state taxpayer's SBT base. Such favoritism of local enterprise, with the concomitant pressure on out-of-state businesses to shift their operations into the state, runs afoul of the bedrock of this Court's Commerce Clause doctrine. *See, e.g., Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984); *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977); *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1962).

As earlier noted, one of the primary reasons Michigan adopted the SBT was to provide incentive for new capital investment in Michigan and "to promote the development and investment of business *within* Michigan." Executive Message of Michigan Governor James J. Blanchard to the Michigan Supreme Court, Pet. App. 79a (emphasis in original).[35] The Michigan Court of Claims has already ruled that the capital acquisition deduction discriminates against out-of-state businesses by providing

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[35] *See also, Analysis of the Michigan Single Business Tax, supra* note 6.

a larger capital acquisition deduction for in-state businesses (those with property and payroll factors that exceed their sales factor) and a lower capital acquisition deduction for out-of-state businesses having identical capital investment in Michigan because their sales factor exceeds their property and payroll factors. *See* note 14, *supra*. No less discriminatory is the incorporation into the Act of an apportionment formula that *underassigns* to Michigan site specific tax base components (compensation and depreciation) of in-state businesses (those with property and payroll factors that exceed their sales factor) and *overassigns* those same site specific tax base components of out-of-state businesses (those with sales factors that exceed their property and payroll factors). In calculating both the capital acquisition deduction and the apportioned tax base, out-of-state businesses are unfairly treated—in one case by receiving the benefit of a lesser deduction; in the other case by receiving a higher assignment of tax base. While the constitutionality of the capital acquisition deduction is not at issue in this case, its discriminatory effect is additional evidence of the legislature's attempt to favor in-state businesses at the expense of out-of-state businesses. Both devices are designed to stimulate, in an impermissible way, capital investment in Michigan in exchange for significant tax benefits. The effect, just as in *Westinghouse Electric Corp. v. Tully*, is to divert new business into the state and to prevent current business from being diverted elsewhere. In sum, the three-factor formula complained of here, just like the capital acquisition deduction, is not "tax neutral." *Boston Stock Exchange*, 429 U.S. at 331; *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 406 (1984).

CONCLUSION

The judgment of the Supreme Court of Michigan should be reversed.

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APPENDIX

APPENDIX

TABLE 4

COMPONENTS OF MICHIGAN TAX BASE

Business Sector	Compensation	% of Column Total	% of Row Total	Business Income	% of Column Total	% of Row Total	Additions	% of Column Total	% of Row Total	Subtractions
Agriculture	$ 126,915,987	0.3	72.1	$ (12,602,299)	(0.4)	(7.2)	$ 71,541,657	0.5	40.6	$ 9,750,533
Mining	219,565,723	0.5	54.6	27,191,969	0.8	6.8	239,722,259	1.7	59.6	84,125,928
Construction	2,131,773,502	4.6	82.5	101,594,020	3.0	3.9	430,399,492	3.1	16.6	78,440,286
Other Durable Manufacturers	3,100,868,105	6.7	77.7	438,663,253	12.8	11.0	638,386,173	4.5	16.0	189,180,129
Non-Durable Manufacturers	3,269,995,332	7.0	66.1	1,003,399,373	29.3	20.3	1,087,689,629	7.7	22.0	411,974,561
Primary Metal Industries	1,353,854,985	2.9	81.7	91,085,053	2.7	5.5	279,344,412	2.0	16.9	66,688,017
Fabricated Metal Products	1,480,260,507	3.2	80.0	171,215,354	5.0	9.3	270,195,376	1.9	14.6	72,247,040
Machinery— Except Electrical	2,201,178,290	4.7	77.7	329,437,362	9.6	11.6	444,475,451	3.2	15.7	141,072,457
Transportation Equipment	10,533,916,766	22.7	94.8	(1,093,328,495)	(32.0)	(9.8)	2,163,536,438	15.3	19.5	497,675,853
Transportation	1,551,436,364	3.3	85.8	(118,151,923)	(3.5)	(6.5)	403,501,511	2.9	22.3	28,858,069
Communications & Utilities	1,392,738,487	3.0	51.4	(20,903,441)	(0.6)	(0.8)	1,385,788,927	9.8	51.1	45,514,715
Wholesale Trade	1,510,291,140	3.3	68.6	442,610,720	12.9	20.1	432,287,622	3.1	19.6	183,159,575
Retail Trade	9,574,169,664	20.6	79.2	890,310,451	26.0	7.4	2,135,508,334	15.5	18.1	555,462,675
Finance Insurance, Real Estate	1,703,262,006	3.7	59.6	(52,666,508)	(1.5)	(1.8)	1,978,897,904	14.0	69.3	773,528,859
Services and Other	6,246,280,456	13.5	67.6	1,222,578,432	35.7	13.2	2,097,690,493	14.9	22.7	330,546,763
All Businesses	$46,396,507,314	100.0	76.7	$3,420,433,321	99.8	5.7	$14,108,965,678	100.1	23.3	$3,468,225,460

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APPENDIX

TABLE 4

COMPONENTS OF MICHIGAN TAX BASE

Business Income	% of Column Total	% of Row Total	Additions	% of Column Total	% of Row Total	Subtractions	% of Column Total	% of Row Total	Total	% of Column Total	% of Row Total
§ (12,602,299)	(0.4)	(7.2)	$ 71,541,657	0.5	40.6	$ 9,750,533	0.3	(5.5)	$ 176,104,812	0.3	100.0
27,191,969	0.8	6.8	239,722,259	1.7	59.6	84,125,928	2.4	(20.9)	402,354,023	0.7	100.1
101,594,020	3.0	3.9	430,399,492	3.1	16.6	78,440,286	2.3	(3.0)	2,585,326,728	4.3	100.0
438,663,253	12.8	11.0	638,386,173	4.5	16.0	189,180,129	5.5	(4.7)	3,988,737,402	6.6	100.0
1,003,399,373	29.3	20.3	1,087,689,629	7.7	22.0	411,974,561	11.9	(8.3)	4,949,109,773	8.2	100.1
91,085,053	2.7	5.5	279,344,412	2.0	16.9	66,688,017	1.9	(4.0)	1,657,596,433	2.7	100.1
171,215,354	5.0	9.3	270,195,376	1.9	14.6	72,247,040	2.1	(3.9)	1,849,424,197	3.1	100.0
329,437,362	9.6	11.6	444,475,451	3.2	15.7	141,072,457	4.1	(5.0)	2,834,018,646	4.7	100.0
(1,093,328,495)	(32.0)	(9.8)	2,163,536,438	15.3	19.5	497,675,853	14.3	(4.5)	11,106,448,856	18.4	100.0
(118,151,923)	(3.5)	(6.5)	403,501,511	2.9	22.3	28,858,069	0.8	(1.6)	1,807,927,883	3.0	100.0
(20,903,441)	(0.6)	(0.8)	1,385,788,927	9.8	51.1	45,514,715	1.3	(1.7)	2,712,109,258	4.5	100.0
442,610,720	12.9	20.1	432,287,622	3.1	19.6	183,159,575	5.3	(8.3)	2,202,029,907	3.6	100.0
890,310,451	26.0	7.4	2,185,508,334	15.5	18.1	555,462,675	16.0	(4.6)	12,094,525,774	20.0	100.1
(52,666,508)	(1.5)	(1.8)	1,978,897,904	14.0	69.3	773,528,859	22.3	(27.1)	2,855,964,543	4.7	100.0
1,222,578,432	35.7	13.2	2,097,690,493	14.9	22.7	330,546,763	9.5	(3.6)	9,236,002,618	15.3	99.9
$3,420,433,321	99.8	5.7	$14,108,965,678	100.1	23.3	$3,468,225,460	100.0	(5.7)	$60,457,680,853	100.1	100.0

TABLE 5

CAPITAL ACQUISITION DEDUCTIONS
FOR
ALL BUSINESSES

Business Sector	Real Property	% of Total	Personal Property After Apportionment	% of Total	Recapture	% of Total	Net	% of Total
Agriculture	$ 7,255,016	0.2	$ 20,334,373	0.2	2,869,598	0.3	$ 24,719,791	0.2
Mining	17,043,446	0.5	87,932,058	0.9	11,363,914	1.3	93,611,590	0.8
Construction	50,627,669	1.6	194,964,270	1.9	27,565,421	3.1	218,245,024	1.8
Other Durable Manufacturers	88,216,943	2.7	393,082,771	3.9	23,692,229	2.7	457,607,450	3.7
Non-Durable Manufacturers	147,853,099	4.5	764,692,618	7.6	23,486,138	2.7	888,883,939	7.2
Primary Metal Industries	19,309,132	0.6	137,690,146	1.4	4,559,948	0.5	152,439,330	1.2
Fabricated Metal Products	35,333,577	1.1	155,313,593	1.5	15,797,645	1.8	174,849,525	1.4
Machinery— Except Electrical	52,435,496	1.6	282,406,626	2.8	30,938,390	3.5	303,903,732	2.4
Transportation Equipment	398,403,847	12.3	3,518,912,702	35.0	43,982,665	5.0	3,873,333,884	31.2
Transportation	33,259,464	1.0	275,299,799	2.7	12,854,094	1.5	295,759,750	2.4
Communications & Utilities	54,596,757	1.7	1,534,200,089	15.3	73,265,270	8.3	1,515,531,576	12.2
Wholesale Trade	62,555,638	1.9	220,911,729	2.2	18,596,229	2.1	264,871,138	2.1
Retail Trade	399,570,484	12.3	1,039,521,534	10.3	181,414,777	20.5	1,257,717,265	10.1
Finance, Insurance Real Estate	1,365,999,848	42.0	386,552,735	3.8	121,415,416	13.7	1,633,160,368	13.1
Services and Other	518,884,063	16.0	1,042,982,428	10.4	292,588,754	33.1	1,269,283,754	10.2
Total	$3,251,344,479	100.0	$10,054,797,471	99.9	$884,390,488	100.0	$12,423,918,116	100.0

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TABLE 8

SINGLE BUSINESS TAX ADJUSTMENTS, 1981

Feature	No. of Businesses	Percent of Businesses [1]	Tax Reductions (Dollars in Millions)
Capital Acquisition Deduction	79,019	60.7%	$312.0
Statutory Exemption	64,636	49.6%	$ 47.0 [2]
Business Loss Deduction	9,702	7.5%	$ 29.5
Labor Intensity Reduction	45,810	35.2%	$162.7
Gross Receipts Reduction	12,153	9.3%	$ 39.9
Small Business Credit	30,464	23.4%	$ 25.6
Unincorporated Business Credit	33,727	25.9%	$ 7.4
Contribution Credit	3,333	2.6%	$ 1.9

[1] Percent of all businesses who filed full SBT returns, including those with zero tax liability.

[2] Minimum: does not include businesses with gross receipts under $40,000, which are not required to file.

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